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AIRPORT COMMISSION:

Concession Audit of Gotham Enterprises, LLC dba Peet's Coffee & Tea

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October 22, 2009

City and County of San Francisco

Office of the Controller – City Services Auditor

AIRPORT COMMISSION:

**Concession Audit of
Gotham Enterprises, LLC dba
Peet's Coffee & Tea**

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October 22, 2009

**CONTROLLER'S OFFICE
CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Mark Tipton, Audit Manager
Donna Crume, Associate Auditor



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

October 22, 2009

San Francisco Airport Commission
P.O. Box 8097
San Francisco International Airport
San Francisco, CA 94128

President and Members:

The Controller's Office, City Services Auditor, presents its report concerning the audit of Gotham Enterprises, LLC, dba Peet's Coffee & Tea (Gotham). Gotham has two lease agreements with the Airport Commission of the City and County of San Francisco to operate six Peet's Coffee & Tea facilities in the San Francisco International Airport (SFO). The first lease has a term of 10 years, expiring on February 23, 2015, and the second has a term of 11 years and 2 months, expiring on November 8, 2015.

Reporting Period: January 1, 2007, through December 31, 2008

Rent Paid: \$1,588,393

Results:

- Gotham overreported \$143,398 in gross revenues and overpaid \$17,060 in rent because it included employee discounts in reported revenues.
- The Airport overbilled Gotham, causing it to overpay its minimum monthly rent by \$859.
- Gotham overpaid its rent by \$15,957 due to using the incorrect lease year to calculate its rent.
- The combined effect of these findings is that Gotham overpaid its rent by \$33,876.

The responses of the Airport and Gotham are attached to this report. The Controller's Office, City Services Auditor, will work with the Airport to follow up on the status of the recommendations made in this report.

Respectfully submitted,

Robert Tarsia
Deputy Audit Director

cc: Mayor
Board of Supervisors
Budget Analyst
Civil Grand Jury
Public Library

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INTRODUCTION

Audit Authority

The Office of the Controller (Controller) has authority under the San Francisco Administrative Code, Chapter 10, Article 1, Section 10.6-2 to audit, at regular intervals, all leases of city-owned real property where rent of \$100,000 or more a year is to be paid to the City and County of San Francisco (City). In addition, the City Charter provides the Controller, City Services Auditor (CSA), with broad authority to conduct audits. This audit was conducted under that authority and pursuant to an audit plan agreed to by the Controller and the Airport Department (Airport).

Background

Gotham Enterprises, LLC doing business as (dba) Peet's Coffee & Tea (Gotham) has two lease agreements with the Airport Commission of the City. Lease 03-0069 has a rent commencement date of December 1, 2004, a term of 10 years, and expires on February 23, 2015. Lease 03-0193 has a rent commencement date of September 1, 2004, for two of the locations and February 24, 2005, for one location, a term of 11 years and two months, and expires on November 8, 2015. The leases allow Gotham to operate six Peet's Coffee & Tea shops at the San Francisco International Airport (SFO).

Both leases require Gotham to pay the Airport monthly the greater of one-twelfth of a minimum annual guarantee (MAG) or a tiered percentage rent of 8 to 12 percent of its gross revenues. The percentage rent rate to be applied each month depends on the cumulative amount of Gotham's total gross revenues per lease year it has reached that month. Lease 03-0069 required monthly MAG rent of \$8,415 for January through December 2007, \$8,704 for January through November 2008, and \$8,914 for December 2008. Lease 03-0193 required monthly MAG rent of \$3,761 for January through December 2007 and \$3,885 for January to December 2008.

Scope and Methodology

The purpose of this audit was to determine whether:

- The monthly statements of gross revenues that Gotham submitted to the Airport accurately reflected actual gross revenues based on monthly and daily records.

- Gotham paid the proper amount of rent to the Airport, according to the terms of its lease.
- Gotham currently has no overdue rent payable to the Airport for the audit period.
- Gotham complied with other provisions of its lease.

The audit covered the period January 1, 2007, through December 31, 2008. However, December 2006 was the first month of the lease year for lease 03-0069. Therefore, to properly assess whether Gotham paid the correct percentage rent under this lease, the auditor included December 2006 in the analysis of rent paid due to Gotham's use of the wrong lease year.

To conduct the audit, the audit team:

- Examined the applicable terms of the lease and the adequacy of Gotham's procedures for collecting, recording, summarizing, and reporting its gross revenues to the Airport.
- Compared on a sample basis Gotham's reported gross revenues to those recorded in its internal monthly summary records in order to determine whether Gotham accurately reported its gross revenues to the Airport.
- Compared on a sample basis Gotham's internal monthly summary records to daily sales reports and other specific source documents.
- Examined the Airport's aged accounts receivable report to determine whether Gotham had any outstanding payments due to the Airport.
- Selected key lease requirements and performed inquiry, observation, and testing to determine whether Gotham complied with other provisions of its leases.

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

AUDIT RESULTS

Gotham Erroneously Included Employee Discounts as Revenues and Consequently Overpaid Its Rent

For the audit period January 1, 2007, through December 31, 2008, Gotham reported gross revenues under both of its leases of \$16,099,960 and accordingly calculated and paid rent of \$1,588,393; however, Gotham incorrectly included in its reported gross revenues discounts it gave to employees. Section 4.1 of each lease lists the items to be excluded from gross revenues. Included in this list is "discount sales to employees, to the extent of the discount." At the request of the auditor, Gotham calculated that it erroneously reported \$143,398 in discounts as revenues during the audit period. This total is consistent with the amount of discounts Gotham reported as revenues during the sample months the audit tested. For the audit period, this error caused Gotham to overpay its rent by \$17,060. Gotham also calculated that the effect of this error since inception of the leases is a rent overpayment of \$32,783.

The Airport Overbilled Gotham When It Adjusted the Minimum Annual Guarantee (MAG) Rent

Gotham overpaid its rent by \$859 because it paid retroactive bills from the Airport for increased monthly minimum rent resulting from annual MAG adjustments. For lease 03-0069, the Airport did not notify Gotham until February 9, 2007, of the increase in monthly minimum rent based on the increased MAG that was effective December 1, 2006. Likewise, for the MAG increase under this lease that was effective December 1, 2007, the Airport did not notify Gotham until February 9, 2008. For lease 03-0193 the Airport did not notify Gotham until March 30, 2007, of the increase in monthly minimum rent due to the annual MAG adjustment that was effective January 1, 2007.

Upon notifying Gotham of the adjusted MAG, the Airport billed Gotham for the increases in minimum monthly rent dating back to the effective dates of the MAG increases. By the time the bills were prepared, Gotham had already paid percentage rent for some billed months that exceeded the new, higher minimum rent. (The minimum monthly rent payments of an Airport tenant such as Gotham, whose percentage rent always significantly exceeds its minimum monthly rent, are early, partial rent payments.) Gotham did not realize it had already paid rent for some months that exceeded the new, higher minimum rent. Gotham paid the retroactive bills and consequently overpaid its rent under

the two leases by \$859. The Airport owes Gotham \$859 for the invoicing error.

**Gotham Overpaid Rent
Because It Used an
Incorrect Lease Year to
Calculate Its Percentage
Rent**

Because Gotham used the calendar year to calculate rent payments due under lease 03-0069 instead of the December to November lease year specified in the lease, Gotham overpaid its rent by \$15,957. Gotham's rent calculations were significantly higher than they should have been because the rental rates increase as the cumulative revenue increases throughout the year. Therefore, starting and ending the year with the wrong months may cause the application of a higher or lower rate to be applied to revenues collected in some months.

Gotham's leases require the rental rate applied to gross revenues to increase, from 8 percent to 10 percent, then to 12 percent, as cumulative revenues reach specified thresholds during the lease year. Under lease 03-0069, all gross revenues during the lease year that exceed \$1,400,000 are subject to the rental rate of 12 percent. Therefore, as Gotham earned more revenue under this lease each year, more revenue was subject to the 12 percent rate, causing large overpayments of rent in December 2006 and December 2007. Although use of the wrong lease year also caused Gotham to underpay rent for some months, the net result was an overpayment of rent.

**The Combined Effect of
the Audit Findings Is
That Gotham Overpaid
Its Rent by \$33,876**

The cumulative effect of these three rent overpayments are summarized in the Exhibit below.

EXHIBIT**Rent Overpayments January 1, 2007, through December 31, 2008**

Period and Description	Rent Paid	Rent Overpayments	Rent Due
<u>January 1, 2007 – December 31, 2007</u>	\$ 757,906		
• Use of Incorrect Lease Year*		\$ 15,957	
• Rent Paid on Employee Discounts		8,556	
• Duplicate Payment of MAG Adjustments		<u>570</u>	
<i>Subtotal</i>		\$ 25,083	\$ 732,823
 <u>January 1, 2008 – December 31, 2008</u>	 \$ 830,487		
• Rent Paid on Employee Discounts		\$ 8,504	
• Duplicate Payment of MAG Adjustments		<u>289</u>	
<i>Subtotal</i>		\$ 8,793	\$ 821,694
 Total	 \$1,588,393	 \$ 33,876	 \$1,554,517

*Note: December 2006 is included in calculation to reflect the full effect of the error.

Source: Airport monthly sales reports and FAMIS cash receipts reports.

Recommendations

The Airport should take the following actions:

1. Refund Gotham \$17,060 for rent it overpaid because it included employee discounts in the gross revenues it reported to the Airport for the audit period.
2. Consult with Gotham to resolve the issue of rent
Gotham appears to have overpaid because it included employee discounts in the gross revenues it reported to the Airport for periods before the audit period.
3. Refund Gotham \$859 for rent it overpaid by paying the Airport's bills for MAG rent increases for past months after it had already paid all rent due for those months.
4. In the future, adjust the MAG and notify tenants promptly of the MAG adjustment to adequately ensure that tenants begin paying the new monthly minimum rent on the effective date of the adjustment. If this is not feasible, the Airport should retroactively bill tenants for the increase in monthly minimum rent only for months for which the rent already paid was less than the new monthly minimum rent.

5. Refund Gotham \$15,957 for rent it overpaid for December 2006 through December 2007 because it used the incorrect lease year of January through December to calculate its rent under one of its leases.

ATTACHMENT A: AIRPORT'S RESPONSE



San Francisco International Airport

October 9, 2009

VIA EMAIL

Mr. Robert Tarsia
Deputy Audit Director
Office of the Controller
City and County of San Francisco
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

P.O. Box 2097
San Francisco, CA 94128
Tel: 415.871.3000
Fax: 415.871.4005
www.sfo.ca.gov

Reference: Concession Audit of Gotham Enterprises, LLC dba Peet's Coffee and Tea
Concession Lease Nos. 03-0069 and 03-0193 by the City and County of
San Francisco, through its Airport Commission.

AIRPORT
COMMISSION
CITY AND COUNTY
OF SAN FRANCISCO

Dear Mr. Tarsia:

GAVIN NEWSOM
MAYOR

LARRY MAZZOLA
PRESIDENT

LINDA S. GRALTON
VICE PRESIDENT

MARK TO

ELEANOR JOHNS

RICHARD J. GUGGENHEIM

JOHN E. MARTIN
AIRPORT DIRECTOR

The San Francisco International Airport ("Airport") is in receipt of the Audit Recommendation from City Services Auditor Division for its audit of Gotham Enterprises, LLC dba Peet's Coffee and Tea Concession Lease Nos. 03-0069 and 03-0193, through its Airport Commission.

The Airport will draft letter to tenant outlining audit findings and reiterate importance of maintaining provisions of the Lease under penalty of fines. The following is the Airport's response to the Audit Report findings:

1. Refund Gotham \$17,060.00 for rent it overpaid because it included employee discounts in the gross revenues it reported to the Airport for the audit period. The Airport agrees with this statement. The Airport request for Auditor to inform Airport how much is to be credited to which lease numbers and what terminal /revenue type (SFO accounting system requires index code sub-object attribution for credits).
2. Consult with Gotham to resolve the issue of rent Gotham appears to have overpaid because it included employee discounts in the gross revenues it reported to the Airport for periods before the audit period. The Airport agrees with this statement and will address issue with tenant.
3. Refund Gotham \$859.00 for rent it overpaid by paying the Airport's bills for MAG rent increases for past months after it had already paid all rent due for those months. The Airport agrees with this statement. The Airport request for Auditor to inform Airport how much is to be credited to which lease numbers and what terminal/revenue type (SFO accounting system requires index code sub-object attribution for credits).
4. In the future, adjust the MAG and notify tenants promptly of the MAG adjustment to adequately ensure that tenants begin paying the new monthly minimum rent on the effective date of the adjustments. If this is not feasible, the

Airport should retroactively bill tenants for the increase in monthly minimum rent only for months for which the rent already paid was less than the new monthly minimum rent. The Airport agrees with this statement.

5. Refund Gotham \$15,957.00 for rent it overpaid for December 2006 through December 2007 because it used the incorrect lease year of January through December to calculate its rent under one of its leases. The Airport agrees with this statement. The Airport request for auditor to inform Airport how much is to be credited to which lease number and what terminal /revenue type (SFO accounting system requires index code sub-object attribution for credits).

Thank you for your staff's work on this audit. Please do not hesitate to call at (650) 821-4500 if you have any questions.

Sincerely,



Cheryl Nashir
Associate Deputy Airport Director
Revenue Development and Management



Wallace Tang
Airport Controller

Attachment

cc: Mark Tipton (Mark.Tipton@sfgov.org)
Vic Bartolome

Recommendation	Responsible Agency	Response
1. Refund Gotham \$17,060 for rent it overpaid because it included employee discounts in the gross revenues it reported to the Airport for the audit period.	AIR	Airport agrees – Auditor should inform Airport how much is to be credited to which lease numbers and what terminal / revenue type (SFO accounting system requires index code sub-object attribution for credits).
2. Consult with Gotham to resolve the issue of rent Gotham appears to have overpaid because it included employee discounts in the gross revenues it reported to the Airport for periods before the audit period.	AIR	Airport agrees – will address issue with tenant.
3. Refund Gotham \$859 for rent it overpaid by paying the Airport's bills for MAG rent increases for past months after it had already paid all rent due for those months.	AIR	Airport agrees – Auditor should inform Airport how much is to be credited to which lease numbers and what terminal / revenue type (SFO accounting system requires index code sub-object attribution for credits).

Recommendation	Responsible Agency	Response
<p>4. In the future, adjust the MAG and notify tenants promptly of the MAG adjustment to adequately ensure that tenants begin paying the new monthly minimum rent on the effective date of the adjustment. If this is not feasible, the Airport should retroactively bill tenants for the increase in monthly minimum rent only for months for which the rent already paid was less than the new monthly minimum rent.</p>	<p>AIR</p>	<p>Airport agrees - will notify tenant promptly in the future.</p>
<p>5. Refund Gotham \$15,957 for rent it overpaid for December 2006 through December 2007 because it used the incorrect lease year of January through December to calculate its rent under one of its leases.</p>	<p>AIR</p>	<p>Airport agrees – Auditor should inform Airport how much is to be credited to which lease numbers and what terminal / revenue type (SFO accounting system requires index code sub-object attribution for credits).</p>

ATTACHMENT B: GOTHAM'S RESPONSE

HIGH FLYING FOODS

Restaurant Group

133 Stillman Street • San Francisco, CA 94107

Office: 415.243.8908 • Fax: 415.243.8695 • Email: firewoodcafe@yahoo.com

Memo

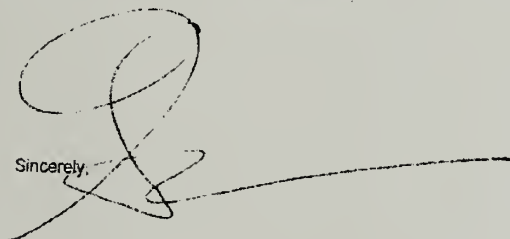
To: Mark Tipton & Donna Crume
From: Glenn Meyers
CC:
Date: 10.16.09
Re: Concession Audit of Gotham Enterprises LLC

Mark & Donna:

I have reviewed the Concession Audit emailed to us on October 14, 2009 and we agree with your findings. Please send your findings to SFO Airport and notify us when you have done so.

I want to thank you for all your hard work. Both you and Donna acted in a very professional manner and made the audit process very pleasant.

Sincerely,



Glenn Meyers
High Flying Foods, Inc.
Corporate Office:
133 Stillman Street
San Francisco Ca 94107
415.243.8909 w
415.243.8695 f
415.706.8171 m

firewood



firewood

